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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 248

GENERAL MANAGEMENT CORPORATION,
A CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

CARL MEYER,
HARRY THOM,
BENJAMIN A. RAGIR,
Attorneys for the Petitioner.

Chicago, Illinois,
August, 1943.

THE BUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

INDEX.

	PAGE
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and Regulations involved	2
Statement	2
Specification of errors to be urged	5
Reasons for granting the writ	6
Conclusion	8
Appendix	9

CITATIONS.

Cases:

R. Simpson & Co., Inc., v. Guy T. Helvering, Commissioner of Internal Revenue, 128 Fed. (2d) 742, certiorari granted June 7, 1943 7

Statutes:

Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 402 9

Sec. 403 9

Miscellaneous:

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

Art. 402-2 10

Art. 403-1 11

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General Management Corporation, by Carl Meyer, Harry Thom and Benjamin A. Ragir, its attorneys, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit entered in the above cause on May 24, 1943, affirming the decision of the United States Board of Tax Appeals (now The Tax Court of the United States).

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 129) is reported in 46 B. T. A. 738. The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. 158) is reported in 135 F. (2d) Advance Sheet No. 6, page 882.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 24, 1943 (R. 163). The Petition for Rehearing was filed within the time prescribed by the rules of the Court (R. 163) and was denied on July 6, 1943 (R. 173). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the act of February 13, 1925 (43 Stat. 936, 28 U. S. C. A. Sec. 347(a)).

Question Presented.

Petitioner, under a contract grossing $24,000.00 during the taxable year, rendered extensive accounting and budgetary services requiring an expenditure of $16,000.00 and also provided its president to act as comptroller for the other contracting party. Were the accounting and budgetary services merely incidental to the comptroller's services so as to qualify the contract as a personal service contract defined in Section 403(e) of the Revenue Act of 1938?

Statutes and Regulations Involved.

The statutes and regulations involved will be found in the Appendix *infra* pp. 9-12.

Statement.

The pertinent facts in this case as found by the Board of Tax Appeals (R. 129) are as follows:

Petitioner, a corporation, was organized for the purpose of rendering budgetary and accounting services and general corporate financial planning services. During 1938, the year in question, of 200 shares of issued and outstanding capital stock of petitioner, 100 were owned by Grant Gillam, 80 were owned by S. Margaret Gillam, Gillam's sister, and 20 were owned by Marguerite Miller.

Gillam had wide experience in corporate management and production and through his contacts petitioner obtained business for which it was organized. During 1938 petitioner had two contracts under which it performed budgetary and accounting services and general management services. One of those contracts was with Magill-Weinsheimer Co. and the Board of Tax Appeals held that said contract was not a personal service contract, contrary to the contention of the respondent. Since no appeal was perfected by the respondent that contract is not now before the Court. The other contract, the one here in issue, was entered into by petitioner with United Printers and Publishers, Inc. (herein referred to as the "United contract") on February 11, 1937. Under the terms of the United contract petitioner for a consideration of $2,000.00 per month was required

> "To furnish from data supplied to it by the Corporation or its various divisions, monthly and annual statements, make up yearly budgets projecting the Corporation's operations, use its best efforts to negotiate such loans, as the Corporation may from time to time require in the regular conduct of its business, check all requisitions and study in detail the Corporation's various operating, management and sales problems, and submit such suggestions as it may have for reducing operating cost and improving the Corporation's profit and financial position."

The United contract, after first stating that the $2,000.00 per month payment shall cover all services required of petitioner, "including the services of said Grant Gillam as comptroller", provided that Grant Gillam shall continue to act as comptroller of United and that—

> "In the event that the said Grant Gillam shall die or shall become incapacitated to such extent as to make it impossible for him to continue as Comptroller of the Corporation and the Company is within three months thereafter unable to supply an individual for

Comptroller who is acceptable to the Corporation, this agreement may, at the option of the Corporation, be terminated."

During 1938 petitioner rendered extensive budgetary and accounting services under the United contract, including the preparation and maintenance of a detailed budget projection, preparation of budget summaries, monthly, quarterly and annual reports, income tax returns and other miscellaneous tax returns and reports. No other audits or reports were prepared by any other accountants and petitioner's audit reports were accepted by bank creditors of United.

Grant Gillam acted as comptroller of United during 1938 but since he was not an accountant and had no accounting experience he did not participate in nor spend any of his time in the rendition of the budgetary or accounting services as an employee of petitioner. Those services were performed by other employees of petitioner, seven in all. The cost to petitioner of rendering those services, in salaries and overhead, was estimated, without dispute or contradiction, to be $16,000.00.

Gillam received a salary from petitioner of $25,000.00 during the year 1938.

The Board of Tax Appeals held (R. 140) the United contract to be a personal service contract under Section 403(e) of the Revenue Act of 1938 on the theory that the services required and rendered under the contract by petitioner's employees other than Gillam were merely incidental to the services required and performed by Gillam. That conclusion resulted in the finding that slightly more than 80% of petitioner's gross income (including the $24,000.00 received under the United contract) was personal holding company income making petitioner a personal holding company under Section 402 of the Revenue Act of 1938 subject to the penalty surtax rates applied

against such companies and a penalty for failing to file a personal holding company return.

The majority opinion of the Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals. Honorable Judge Minton in his dissenting opinion stated:

> "In the contract that produced the considerations the Government would tax, the petitioner contracted for and rendered budgetary, accounting and income tax services that Gillam was wholly incapable of performing, and some of which, such as the making of income and other tax reports, could not have been of the slightest assistance to Gillam in the performance of his services. Indeed, of the services rendered by the petitioner to earn the $24,000 income involved in this case, $16,000 was for services rendered by petitioner's staff other than Gillam. I cannot agree that these services were incidental, and on a par with those of a craftsman's helper who 'fetched and carried' tools and materials for the craftsman to perform his job. These large and valuable services, which Gillam did not and could not perform, were not rendered just in apprenticeship or as assistance to Gillam in the performance of his duties. The services were independent services rendered by the petitioner. Gillam did not render all of the services paid for. He did not render over a third of the total services performed by the petitioner."

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the budgetary and accounting services rendered under the United contract were merely incidental to the services rendered by Gillam and that the contract was therefore a personal service contract under Section 403(e) of the Revenue Act of 1938.

(2) In holding that the personal service contract section (Section 403(e) of the Revenue Act of 1938) included

a contract requiring services which were not and could not be performed by the individual designated in the contract.

(3) In holding that petitioner was a personal holding company under Section 402 of the Revenue Act of 1938.

(4) In affirming the decision of the Board of Tax Appeals.

Reasons for Granting the Writ.

(1) In the present case the Circuit Court of Appeals for the Seventh Circuit has so construed Section 403(e) of the Revenue Act of 1938, which is presently incorporated in Section 502(e) of the Internal Revenue Code, so as to subject to the severe personal holding company surtaxes legitimate personal service corporations which were never intended to be so subjected by Congress.

Section 403(e) was adopted by Congress to prevent instances—

> "where an individual with unique talents, whose compensation for personal services was large, formed a corporation which contracted with him for his services at a relatively modest figure, and then contracted out his services with third persons at a much higher figure. The corporation accumulated the difference between the sums received and the sums paid to the individual, and under existing law paid only the corporate normal and undistributed-profits taxes thereon * * *." (House Ways and Means Committee Report on Section 403 of the Revenue Act of 1937, 1939-1 (Part 2) C. B. p. 707.)

The Committee Report continues:

> "The provision that some third party must have the right to designate *who* shall perform *the* services contracted for, or that *the* person to perform *the* services must be designated in the contract, will prevent this rule from applying in general to operating corporations engaged primarily in rendering personal services and which necessarily enter contracts to

render such services, selecting such members of their staff as they desire to render such services." (Italics supplied.)

This Court should now decide whether legitimate personal service corporations, such as accounting, architectural or advertising concerns, are subject to the confiscatory personal holding company surtaxes in the event clients of such corporations rely upon principal officers of the corporations and insist upon their final judgment even though a greater portion of the services required by contracts cannot be performed by the principal officer and are actually performed by other employees of the corporation who are so designated by the corporation and not by the client. The costs of such services by others may consume more than 50% of the compensation received or as high as 66⅔% of such compensation, as is the case in the cause here presented.

In all fairness to such legitimate personal service companies, they should now be informed as to their tax liability and this Court should now decide whether 90% or more of their total net income may be consumed in the payment of taxes and penalties. In the instant case in excess of 92% of petitioner's 1938 net income has been so consumed under the decision of the Circuit Court of Appeals.

This Court has recently recognized the advisability of passing upon the propriety under the personal holding company sections of the law of imposing penalties for failure to file personal holding company returns. In the case of *R. Simpson & Co., Inc., petitioner* v. *Guy T. Helvering, Commissioner of Internal Revenue, respondent*, 128 F. (2nd) 742, this Court on June 7, 1943 granted a writ of certiorari to review that question.

(2) The Circuit Court of Appeals in its decision legislates so as to change the clear language of Section 403(e). That section includes within its purview contracts under

which a corporation is to furnish personal service if the contract designates *the* individual *who* is to perform the services. The Section does not include a contract which designates an individual who is to perform only part of the services required under the contract. The Section reads:

> "(e) Personal Service Contracts—(1) amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) *the* individual *who* is to perform *the* services, or if *the* individual *who* is to perform *the* services is designated (by name or by description) in the contract; and (2) amounts received from the sale or other disposition of such a contract. This sub-section shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 per centum or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for *the* individual *who* has performed, is to perform, or may be designated (by name or by description) *as the one to perform,* such services." (26 U. S. C. A. p. 1130, Act 1938, Sec. 403.) (Italics supplied.)

In view of the penalty nature of the Act, this Court should now decide whether the Circuit Court of Appeals' construction is a proper one under the language of the law.

Conclusion.

For the foregoing reasons it is respectfully submitted that this Petition for a Writ of Certiorari should be granted.

CARL MEYER,
HARRY THOM,
BENJAMIN A. RAGIR,
Attorneys for the Petitioners.

Chicago, Illinois,
August, 1943.